

Memorandum

190.2721

To : Mr. J--- B---
--- - Branch Office, Auditing

Date: July 22, 1993

From : Donald L. Fillman
Tax Counsel

Subject: **Sales or Use Tax on Materials Utilized in
Out-of-State Projects by the H--- Corporation,
Account No. SZ --- XX-XXXXXX**

This is in response to your memo of May 6, 1993. You requested our opinion concerning the application of sales or use tax to materials taken from inventory for use out of state.

You have stated that the materials in inventory are all ex-tax because H--- used the following three accounting methods to keep all of its inventory ex-tax:

1. It gave resale certificates to California vendors;
2. It did not pay use tax on out-of-state purchases; and
3. It took a credit upon return of material from California jobs to inventory, upon which it had previously paid tax, thus converting tax paid materials back to ex-tax materials.

It is our opinion that H--- is improperly attempting to convert tax-paid materials to ex-tax materials, to avoid the proper payment of sales and use taxes. There is no provision for such a "conversion."

The only proper reasons for holding ex-tax inventory of materials by a construction contractor are (1) to hold for resale in the regular course of business, and (2) to hold for subsequent use solely outside this state. Rev. & Tax. Code § 6008. However, Revenue and Taxation Code section 6009.1 excludes from the definition of "storage," "the keeping, retaining or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside this state for use thereafter solely outside the state,"

The question which immediately arises is whether materials which are initially purchased for resale in the regular course of business, and held in inventory for that purpose, may be withdrawn from inventory and shipped outside this state for use thereafter solely outside the state, without the payment of a use tax. An initial reading of (1) Revenue and Taxation Code section 6386, and (2) Annotation 190.2730 would seem to preclude this: section 6386 states that "[t]his exemption shall apply only if the purchaser certifies in writing to the seller ... that the property will be used" in this manner; and Annotation 190.2730 provides that such certificate may only be used if the seller obtains the certificate from the purchaser "at the time of the transaction."

The Board has long held, however, that if the purchaser is a retailer as well as a construction contractor, a resale certificate may be accepted, provided the purchaser "is unable to tell at the time of the purchase whether the property will be consumed or resold." (See Annot. 190.2720.) This specific annotation was written concerning an out-of-state construction contractor, but has been applied to in-state construction contractors as well.

Sales tax reimbursement is due on the sale, and use tax is due and payable with the tax return for the period of the purchase, unless an exemption is available. (See Reg. 1668 (a)(2).)

There is no provision for taking a tax credit when materials purchased for a specific job, upon which tax was paid, are returned to inventory. No return to inventory will allow a tax credit. If tax paid materials are purchased with the intent to use them on a California job, but are resold before any use is made of them, a "tax paid purchase resold" credit is allowed. (See Reg. 1710.)

The above discussion provides an answer to each of your specific questions, which answers are summarized following the question, as follows:

Question 1:

Would H--- be allowed to convert tax paid materials consumed/allocated on California jobs to an ex-tax basis and be able to take those materials to out-of-State projects without any tax due?

Answer:

There is no provision for converting tax paid materials to ex-tax materials by changing the intended use from a California project to an out-of-state project.

Question 2:

Is the Audit Staff correct in its interpretation as described above, and therefore, all materials withdrawn from that converted ex-tax inventory for out-of-State jobs are subject to the use tax? The measure involved is over \$3,000,000.

Answer:

No. The Board has allowed tangible personal property which is purchased for resale to be used for another exempt purpose, such as use solely for an out-of-state purpose, to be converted to such other exempt purpose without the payment of use tax.

Question 3:

Is H--- entitled to the storage and use exclusion as described in section of the law 6009.1 for the out-of-State purchases, regardless that those purchases were allocated to a construction job in California and that use tax was paid to the B.O.E. at that time? If this is the case, segregation of the inventory at this point may be an impossible task.

Answer:

No. If tangible personal property is sold for a purpose requiring the payment of sales tax reimbursement, or for a use requiring the collection of a use tax, no credit is available for a subsequent change to an exempt purpose.

Attorney General Opinion No. 52-112, dated March 24, 1953, which you inquired about by telephone, was made invalid by a subsequent revision of Revenue and Taxation Code section 6094. That Attorney General opinion had held that a construction contractor that withdrew inventory for shipment out of state, for use solely out of state, but which had been purchased ex-tax (with a resale certificate), could not be so converted. A use tax was due on such withdrawal. This opinion may no longer be followed.

If you have further questions, please contact me.

DLF:wk